TESTIMONY OF

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Resources Committee

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Madam Chairman and Members of the Subcommittee, I appreciate the opportunity to appear today to present testimony on the Minerals Management Service's (MMS) examination and implementation of programs to take oil and gas royalties "in kind." In testimony submitted for the July 31, 1997 hearing on royalty in kind before the Subcommittee, MMS Director Cynthia Quarterman provided background information and a summary of the draft report of our 1997 Royalty in Kind Feasibility Study. My testimony today will focus on our future plans as we proceed toward implementing the report's recommendations. Before discussing these plans, I would like to briefly summarize the findings and recommendations of our final feasibility study report.

Final Report of the 1997 Royalty in Kind Feasibility Study

MMS released the final report on September 2, 1997. Copies were distributed to members of the Subcommittee and staff on September 3, 1997. We have brought additional copies for interested individuals present at today's hearing. The report is also available on the Internet on the MMS Home Page (www.mms.gov). The primary objective of the study was to determine if implementation of an RIK program or programs for Federal oil and gas is in the best interest of the United States, and, if so, under what circumstances. The phrase "best interest of the United States" refers to a program that would:

1. Offer potential revenue neutrality or enhancements to the U.S. Treasury; and

2. Provide extensive administrative relief for MMS and industry.

The overall conclusion of the study is that RIK programs could be workable, revenue neutral or positive, and administratively more efficient for MMS and industry. Key elements of a successful Federal RIK strategy would include:

- Downstream Market Presence: To be revenue neutral/positive, an MMS program must strategically participate in downstream services and value enhancements, either through contracting with energy marketers or in-house marketers and associated staff.

- Aggregation: Provision of substantial volumes could provide MMS and its marketing agent(s) with increased market opportunities primarily through assurance of supply.

- Administrative Relief: The greatest relief would accrue under a broadly-applied, multi-year program through decreased reporting to MMS and discontinuation of audits of the producers' shares.

However, RIK programs would have reduced chances for success if implemented under the following unfavorable conditions: (1) audits of the producers' shares; (2) legislation directing MMS to take in kind for all commodities in all areas or at the lessees' discretion; (3) acceptance of production at less than marketable condition; and (4) payment of above market rates for transportation on non-jurisdictional pipelines.

The report concludes that a natural gas RIK program in the Gulf of Mexico has the greatest chance of success of any potential MMS initiative, especially if it involves substantial volumes; is long-term; engages one or several marketers; and provides a formula for MMS sharing in downstream value additions secured by MMS's energy marketer(s). The report also concludes that while detailed economic effects cannot yet be determined, such a program is anticipated to be both revenue positive and administratively more efficient for the many reasons described in the report. Accordingly, the report recommends implementing an RIK pilot program for Gulf of Mexico natural gas consistent with the key success factors described above.

For crude oil, the report concludes that the information is equivocal, and the revenue and administrative implications are uncertain. However, the report indicates there is significant interest on the part of producers, marketers, and the State of Wyoming in taking crude oil in-kind from Federal leases in Wyoming. Thus, the report recommends that a crude oil pilot--developed in concert with all affected parties--be instituted in Wyoming to test revenue and administrative effects.

Similarly, the report notes that the State of Texas has expressed a significant amount of interest in an RIK program for Outer Continental Shelf (OCS) 8(g) leases offshore from the State. Consequently, because of the potential for a successful OCS Gulf of Mexico gas program, the report recommends that MMS and Texas jointly explore the possibilities of RIK programs involving these properties.

Province of Alberta Program

The Subcommittee's August 28, 1997 invitation to MMS to participate in this hearing included a request that we describe any analyses performed by MMS comparing the current U.S. royalty management system to Alberta's RIK scheme. We have not conducted a detailed economic analysis comparing the two systems primarily because we were not presented with any source documentation or other information from the Province upon which we could verify their asserted revenue enhancement of 7 cents (Canadian) per barrel.

However, we have spent some time qualitatively assessing the implications of the Alberta crude oil RIK program in regard to U.S. production. We conclude that there are important differences between the Alberta production environment and that of onshore U.S. production areas--differences that give us pause as we consider RIK scenarios for onshore crude oil. For example, Alberta produces roughly the same amount of crude oil as currently produced from the Gulf of Mexico in a very concentrated, relatively small geographic area with a somewhat limited pipeline infrastructure and nearby refinery capacity. The situation is markedly different than onshore in the United States, with its more than 36,000 oil wells, 2,600 operators, and 23,000 producing leases scattered remotely throughout numerous geologic basins in 28 revenue-receiving States. The learning curve for the Federal Government to commence an across-the-board onshore RIK program would be prodigious, and perhaps more complex than the existing in-value system. It seems obvious to us that implementation of a new crude oil RIK system in the onshore environment would be a large and complex undertaking, one that should be attempted **only** if the revenue and administrative impacts for all parties are substantially positive.

Future Activities

Our senior management team at MMS has accepted the recommendations of the feasibility study report in concept, and we intend to proceed developing specific program models consistent with the favorable conditions previously mentioned. Our first course of action is to consult with the Administration, Congress, States, and industry on the results of our conceptual study and our next steps. During the past two weeks, we have spoken to congressional staff of Members interested in this issue. Director Quarterman has sent a formal invitation to Governor Geringer of Wyoming to join with us in a joint exploration of RIK opportunities for crude oil in that State. We have also formally invited the State of Texas' General Land Office to join us in examining potential RIK programs for Texas 8(g) leases. Lastly, we have planned a meeting with industry representatives to discuss these matters, to be held on September 22, 1997.

In regard to natural gas from the Gulf of Mexico, we will soon form an implementation project team. The team will identify the scope and overall framework of the proposed royalty marketing alliance program and will involve the oil and gas industry in the development of program details. A crucial decision point will follow and will be based on detailed economic analyses of business proposals submitted by energy marketers or developed internally. The results of the analyses will be critical to the decision on whether to implement the pilot program, a decision that will be made by the Department in conjunction with the Office of Management and Budget.

Concurrent with this process, we will be working with the States of Wyoming and Texas to identify and develop pilot programs for Federal leases in Wyoming and the 8(g) area off Texas, respectively.

I would like to reiterate and emphasize the comments made by Director Quarterman earlier this summer that we will not make any final decisions to implement programs before detailed analyses of specific programs are completed. I also want to repeat our belief that it is not wise to make legislative decisions before comprehensive analyses are conducted. Any statutory or regulatory assistance that may be necessary will depend on the specific nature of any program that is developed. At this point, it is premature to guess what type of legislative assistance, if any, may be needed.

In closing, let me state that we are enthusiastic about the prospects of implementing successful RIK programs for Federal mineral leases. We believe that such programs potentially provide an innovative way to dramatically streamline the royalty management process--in a manner that could also increase revenues for the U.S. Treasury. We are quite serious about giving the RIK concept every chance for successful implementation.

Thank you Madam Chairman and Members of the Subcommittee, this concludes my prepared remarks. I would be pleased to answer any questions you may have.